

Message Text

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AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY TOKYO

AMEMBASSY VIENNA

USMISSION EC BRUSSELS

USMISSION OECD PARIS

AMCONSUL FLORENCE

AMCONSUL MILAN

AMCONSUL NAPLES

AMCONSUL GENOA

AMCONSUL PALERMO

AMCONSUL TRIESTE

AMCONSUL TURIN

C O N F I D E N T I A L ROME 14119

E.O. 11652: GDS

TAGS: ECON ELAB ENRG IT

SUBJECT: IMPACT OF OIL SHORTAGE ON ITALIAN ECONOMY

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1. BEGIN SUMMARY. IN CONTACTS WITH BOTH GOVT AND NON-GOVERNMENTAL ECONOMIC FORECASTING SOURCES, EMB HAS OBTAINED SEVERAL PROJECTIONS OF EXPECTED IMPACT OF OIL SHORTAGE ON ITALIAN ECONOMY IN 1974. BASED ON ASSUMED SHORTFALL OF 20 PERCENT OF CRUDE OIL REQUIRE-

MENTS FOR ENTIRE YEAR 1974, CONSENSUS IS THAT INDUSTRIAL PRODUCTION WILL DECLINE ABOUT 2 PERCENT, GNP WILL STAGNATE, OR GROW POSSIBLY BY 1 PERCENT, AND UNEMPLOYMENT WILL RISE ABOUT 400,000 TO 1 MILLION. ADVERSE BALANCE OF PAYMENTS IMPACT IN RANGE \$1.5 TO 2.0 BILLION WOULD ADD TO SIGNIFICANT BALANCE OF PAYMENTS DEFICIT ALREADY ANTICIPATED FOR 1974. END SUMMARY.

2. ON GOVERNMENTAL SIDE, SECGEN FOR PLANNING (RUFFOLO) IN MINISTRY OF BUDGET AND ECONOMIC PLANNING IN RECENT PARLIAMENTARY TESTIMONY ON ENERGY CRISIS STATED THAT CONTINUED OIL SHORTAGE IMPLIES SERIOUS SACRIFICES FOR ITALIAN ECONOMY. WORKING ON ASSUMPTION OF 1974 CRUDE OIL SHORTFALLS OF 10, 20, OR 30 PERCENT, RUFFOLO SUGGESTED FOLLOWING CONSEQUENCES FOR GNP: 10 PERCENT SHORTFALL -- ZERO GROWTH; 20 PERCENT SHORTFALL -- DECLINE OF 2.7 PERCENT; 30 PERCENT SHORTFALL -- DECLINE OF 6 PERCENT. UNEMPLOYMENT RATE WOULD INCREASE BETWEEN 1 PERCENT (10 PERCENT CRUDE SHORTFALL) AND 4.5 PERCENT (30 PERCENT SHORTFALL). RESEARCH OFFICE AT BANK OF ITALY AND ISTITUTO NAZIONALE PER LO STUDIO DELLA CONGIUNTURA (ISCO) SEEM TO BE TAKING MORE RELAXED VIEW OF EFFECT OF PETROLEUM CRISIS ON 1974 GNP. BANK APPARENTLY HAS LIMITED ITS EFFORTS TO CALCULATING EFFECT OF CONSERVATION MEASURES ALREADY TAKEN, WHICH IT ESTIMATES AT 1.5 PERCENT REDUCTION IN PRIVATE CONSUMER DEMAND IN REAL TERMS IN 1974. HEAD OF ISCO TOLD EMBOFF THAT INSTITUTE DID NOT INTEND TO RE-COMPUTE 1974 GNP IN REAL TERMS, SINCE MAJOR IMPACT WOULD BE THROUGH SHIFT WITHIN PRIVATE CONSUMPTION DEMAND FROM CONSUMPTION OF PETROLEUM-RELATED GOODS AND SERVICES TO OTHER GOODS AND SERVICES NOT CLOSELY DEPENDENT ON PETROLEUM. ISCO RECOGNIZES THAT THERE COULD BE IMPORTANT PRICE EFFECT ON GNP IN MONETARY TERMS.

3. IN PRIVATE SECTOR, EMBASSY SPOKE WITH ECONOMIC PLANNING DIVISIONS OF ESSO AND SHELL ITALIANA, BOTH OF WHICH HAVE RECENTLY COMPLETED STUDIES ON EXPECTED ECONOMIC IMPACT OF OIL SHORTAGE IN ITALY. AS THE STUDIES WERE FOR INTERNAL COMPANY USE ONLY, EMB GAVE ASSURANCE THAT THEIR CONFIDENTIALITY WOULD BE RESPECTED. OF TWO STUDIES, ESSO ONE IMPRESSED US AS BEING MOST THOROUGH AND CONFIDENTIAL

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INTELLECTUALLY EXACTING, EXAMINING ECONOMY SECTOR BY SECTOR. SHELL ANALYSIS WAS MUCH LESS DETAILED, WITH CONCLUSIONS BASED ON ASSUMED FIXED RELATIONSHIP BETWEEN ENERGY CONSUMPTION AND GNP LEVEL (ONE PERCENT INCREASE IN GNP CORRESPONDS TO A 1.2 - 1.3 PERCENT INCREASE IN ENERGY CONSUMPTION.)

4. ESSO STUDY ASSUMED 20 PERCENT SHORTFALL IN 1974 CRUDE OIL NEEDS, EQUIVALENT TO 14 PERCENT SHORTFALL IN OVERALL ENERGY REQUIREMENTS. IT PROJECTED SHORTFALLS AND CONSEQUENCES IN TERMS OF "TRANSPORTATION, "HOUSEHOLD AND "INDUSTRIAL" SECTORS, WITH ASSUMPTION THAT CURRENT GOVT AUSTERITY MEASURES SUPPLEMENTED BY LIKELY GASOLINE RATIONING IN SPRING 1974 WOULD SEEK TO LIMIT CONSUMPTION IN FIRST TWO SECTORS AND THUS MINIMIZE EFFECTS UPON INDUSTRIAL SECTOR. CUTS IN THE THREE SECTORS (IN TERMS OF NORMAL 1974 "OIL"

AND "ENERGY" REQUIREMENTS) ESTIMATED AS FOLLOWS: TRANSPORTATION: 16 PERCENT OIL AND 16 PERCENT ENERGY, WITH EMPHASIS ON CURTAILMENT GASOLINE CONSUMPTION. HOUSEHOLD: 30 PERCENT OIL AND 20 PERCENT ENERGY, WITH DECREASED HOME HEATING ACCOUNTING FOR BULK OF CUT. (ESSO STUDY ASSUMED POSSIBLE FURTHER INCREASES IN PRICES OF GASOLINE AND HEATING OIL TO LIMIT CONSUMPTION AND PROVIDE TAX REVENUE. SUGGESTED POSSIBLE PRICE FOR PREMIUM GASOLINE OF 250 LIRE PER LITER COMPARED TO PRESENT 200 LIRE PER LITER. NEARLY ALL OF RISE WOULD BE TAX INCREASE.) INDUSTRY: DESPITE GOVT COMMITMENT TO MAINTAIN GROWTH, THIS SECTOR WILL ALSO SUFFER, DUE AS MUCH TO BOTTLENECKS ARISING (E.G. SHORTAGE OF DIESEL FUEL, SLOWING RAW MATERIAL DELIVERIES) AS TO LACK OF HEAVY FUEL OIL; OIL SHORTFALL OF 16-17 PERCENT EXPECTED, EQUIVALENT TO 10 PERCENT ENERGY. STUDY ASSUMES ACCELERATED CONVERSION OF INDUSTRY FROM HEAVY FUEL OIL TO NATURAL GAS, ESPECIALLY IN NORTH, NOTING THAT FIAT, OLIVETTI AND ZANUSSI CONVERSION ALREADY UNDERWAY.

5. ESSO ANALYSIS CONCLUDES FOLLOWING OVERALL IMPACT ON ECONOMY OF ABOVE SHORTFALLS: "INDUSTRIAL PRODUCTION" DOWN 2-2.5 PERCENT, WITH AUTO, IRON AND STEEL, MECHANICAL, PETROCHEMICAL AND CERTAIN HIGH VALUE ADDED SECTORS (E.G., FOOD PROCESSING) ESPECIALLY HURT. "GNP" GROWTH 0-1 PERCENT, AS OPPOSED TO EXPECTED PRE-CRISIS GROWTH OF 6 PERCENT. CONSUMER PRICES UP 15 PERCENT, AS OPPOSED TO PRE-CRISIS PROJECTED INCREASE OF 8 PERCENT. UNEMPLOYMENT LEVEL ABOUT 900,000 OF 19 MILLION WORK FORCE AS AGAINST NORMAL UNEMPLOYMENT LEVEL OF 650,000-680,000. NET BALANCE OF PAYMENTS EFFECT OF OIL PRICE INCREASES FORECAST AT 1,000 BILLION LIRE (\$1.7 BILLION);
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BASED ON 20 PERCENT CUT THROUGHOUT ENTIRE YEAR OR 1,500 BILLION LIRE (\$2.5 BILLION) IN EVENT OF 20 PERCENT SHORTFALL 1ST QUARTER ONLY.

6. SHELL STUDY NOTES (AS DID ESSO) THAT IN ABSENCE OF OIL SHORTAGES, GNP HAD BEEN EXPECTED TO INCREASE ABOUT 6 PERCENT. CONCLUDES THAT VARIOUS OIL SHORTFALLS WILL CORRESPOND TO GNP LEVELS AS FOLLOWS: 10 PERCENT SHORTFALL--GNP GROWTH OF 2 TO 3.5 PERCENT; 15 PERCENT SHORTFALL--GNP 0 TO 1.5 PERCENT; 20 PERCENT SHORTFALL--GNP DROP OF 1 TO 3 PERCENT. SHELL STUDY PREDICTS INCREASED FOREIGN EXCHANGE COST IN 1974 OF RECENT CRUDE OIL PRICE RISES TO BE IN EXCESS 1,000 BILLION LIRE (\$1.7 BILLION).

7. CONCLUSION: BASED ON ABOVE SOURCES, OUR EVALUATION OF CONSEQUENCES FOR ITALIAN ECONOMY OF 20 PERCENT OIL SHORTFALL DURING ENTIRE YEAR 1974 TENDS TO PARALLEL THAT REACHED IN ESSO STUDY -- I.E., A DROP IN INDUSTRIAL PRODUCTION, DESPITE FIRM GOI COMMITMENT TO PREVENT COMPROMISE OF ECONOMIC RECOVERY UNDERWAY AT TIME OF ARAB SUPPLY CUTBACK; WITH ABOUT ZERO GROWTH IN GNP, WHICH WOULD REPRESENT THE WORST POST-WORLD WAR II PERFORMANCE FOR THE ITALIAN ECONOMY (AT THE BOTTOM OF THE RECENT ECONOMIC SLOWDOWN, GNP GREW BY 1.6 PERCENT IN 1971); AND CONSIDERABLE INCREASE IN UNEMPLOYMENT TO AROUND 1 MILLION, A LEVEL WHICH UNDER NORMAL CIRCUMSTANCES WOULD

BE CONSIDERED POLITICALLY INTOLERABLE BY GOI. INCREASE IN NET IMPORT BILL OF \$1.5 TO \$2.0 BILLION DURING YEAR WHEN LARGE DEFICIT ALREADY ANTICIPATED RAISES SERIOUS QUESTION ABOUT HOW DEFICIT CAN BE FINANCED AND ABOUT LIRA EXCHANGE RATE PROSPECTS FOR 1974.

8. WE WOULD UNDERLINE THAT THESE ASSUMPTIONS PREDICATED ON 20 PERCENT OIL SUPPLY CUT THROUGHOUT ENTIRE YEAR 1974. IF SHORTFALL WERE TO INCREASE, RESULTS WOULD BE EVEN MORE NEGATIVE. IF, ON OTHER HAND, CUTBACKS WERE RELAXED IN THE COURSE OF THE YEAR, ABOVE ESTIMATES COULD PROVE TO BE OVERLY PESSIMISTIC. VOLPE

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